3/18/88 BS350-2

MANUFACTURERS HANOVER

Financial Digest

Volume XXIV, Number 24 Monday, November 23, 1987

Analysis of Business Trends Plus Selected Financial Indicators

The Louvre Accord Collapses

The recent renewed weakness of the dollar raises new questions about the Louvre Agreement and its implied currency target zones. The February 22, 1987, Louvre Currency Accord gave the foreign exchange markets a period of unaccustomed stability. The agreement among the major industrial nations was prompted by concerns that any further decline in the dollar would have a detrimental impact upon the world economy. Thus, stabilizing the dollar became a paramount priority. In order to achieve this objective, the U.S. pledged to renew its efforts to cut its huge Federal budget deficit, while Japan and Germany pledged to take steps to stimulate their economies. Realizing that such policies would take time to work, central banks vowed to intervene in the interim whenever it became necessary to promote exchange rate stability.

The agreement did succeed in dampening exchange rate volatility for most of the year, keeping the dollar roughly in a narrow trading range of 1.80-1.90 Deutschemarks and 140-150 yen. In part, an unprecedented $90-$100 billion in central bank intervention during this period helped to explain this development, as did statements by world financial leaders emphasizing cooperation and coordination of monetary and fiscal policies. However, in late October, the agreement began to unravel in acrimonious bitterness among the participants, particularly Germany and the U.S. As a result, the dollar once again renewed its descent, sinking to record low levels against the mark, yen, Swiss franc and Dutch guilder, while sliding to a five-year low against the U.K. pound sterling.

It was evident from the outset that the Louvre Agreement could only buy time until the necessary macroeconomic policies were put in place to rectify the imbalances overhanging the world economy, especially the large U.S. trade deficit, which will reach $170 billion this year, and the enormous trade surpluses of Japan and Germany. In this regard, it was essential that the U.S. stop living *beyond* its means by cutting the Federal budget deficit, while Germany and Japan stopped living *below* their potentials by stimulating their domestic economies. Unfortunately, few steps were taken to rectify these imbalances.

A Need For Global Coordination

Instead, the U.S. again put off efforts to reduce effectively its sizable budget deficit while Germany's anti-inflation fixation prevented it from stimulating domestic demand. Although Japan did take steps to expand domestic demand, its measures proved somewhat tentative with no concrete action taken to reduce its high food and real estate costs, nor to cut taxes substantially. Meanwhile, with money supply growth exceeding target levels as a result of massive intervention to support the dollar, both Japan and Germany began to tighten their monetary policies to the chagrin of the Administration which had hoped that overseas interest rates would drop in order to stimulate world economic activity.

It is not surprising, therefore, that the Louvre Accord collapsed as once again the major countries refused to take the politically difficult steps to rectify their budget and trade imbalances. Two catalysts in this respect speeded up the demise of the Louvre Agreement. One was the August U.S. trade deficit, which although narrower than July's, showed an unacceptably large $15.7 billion shortfall, the third largest monthly red-ink total in 1987 and 12 percent above year-ago levels. The second, and perhaps key, catalyst was U.S. Treasury Secretary Baker's warning to the Germans that unless they ceased tightening their monetary policy, the dollar would be allowed to fall. The foreign exchange markets took this statement as a clear sell signal and proceeded to dump dollars en masse, sending the dollar crashing below the psychologically significant 1.70 mark and 140 yen levels.

Manufacturers Hanover Economics Department 17/270

Copyright 1987 Manufacturers Hanover Corporation 270 Park Avenue, New York, NY 10017

Despite pronouncements to the contrary by major world finance leaders, it seems that the Louvre Accord has suffered a severe setback and, if nothing else, it will be difficult to re-establish the former harmony. What is more, it would appear that the U.S. once again views a cheaper dollar as the principal mechanism for correcting the huge trade deficit. This, though, is a flawed policy. Exchange rate movements by themselves cannot substantially reduce trade imbalances without corresponding and complementary changes in savings, investment and fiscal policy. This has not been done in the U.S., nor have the Europeans and Japanese helped matters since they have refused to stimulate their economies substantially.

More Is Needed To Reduce Trade Deficit

It should be evident to the U.S. Administration that dollar devaluation is not the only answer. The trade deficit has widened—not diminished—since the dollar reached its peak in February 1985. From a shortfall of $31.37 billion in the first quarter of 1985, the deficit soared to $46.23 billion in the third quarter of 1987. Although in volume

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/4/87)	172,576	+ 861	+ 18,458
New York City (11/11/87)	38,397	– 61	+ 4,375
Commercial Paper			
(11/11/87)	356,066	– 4,255	+ 25,243

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/4/87)	276,812	+ 1,683	+12,371
New York City (11/11/87)	58,563	– 619	– 2,274

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/4/87)	810,260	– 2,758	+55,463
New York City (11/11/87)	176,827	– 1,809	+11,472

Financial Markets

	Friday 11/20/87	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.83%	– .24	+ .35
180-Day Bills†	6.51	– .17	+ .93
Longest Bills†	6.57	– .42	+ .84
Recent Issues:			
7 7/8S 11/30/87 (When Issued)	7.61	NA	
9 1/8S 9/30/91	8.31	+ .15	
8 7/8S 11/15/97	8.78	– .03	
8 7/8S 8/15/17	8.87	– .02	
Municipals:			
Bond Buyer–20 Bond Index* (11/19/87)	7.91%	– .12	+ 1.13
Blue List Total ($ Million)	$1,065	+ $160	–$ 746
30-Day Visible Supply ($ Million)	$1,545	– $847	–$2,614
Total	$2,610	– $688	–$3,360
Corporates:			
Moody's Aa Composite (11/19/87)	10.23%	+ .01	+ 1.09
30-Day Visible Supply ($ Million)	$2,155	– $647	–$ 555
Stocks:			
Dow-Jones Averages:			
Industrials	1,913.63	– 21.38	+ 20.07
Transportation	726.29	– 19.28	– 112.59
Utilities	180.18	– 1.78	– 31.30
65 Stocks	706.23	– 10.55	– 41.36
N.Y.S.E. Composite Index	135.56	– 2.04	– 5.38
N.Y.S.E. Avg. Daily Vol. for Week (000's)	163,613	– 11,197	– 8,847

*34% Taxable equivalent 11.98%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/20/87	Week Ago
Overnight	6.56%	6.69%
1 month	6.81	6.75
3 month	7.38	7.31
6 month	7.38	7.38
1 year	7.81	7.75
EURODOLLAR BONDS Average Yield		
Medium Term (5 yrs.)	8.93%	8.92%
Long Term (10 yrs.)	9.78	9.72

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/20/87)	Currency Per U.S. $	Week Ago
Canada	1.3105	1.3184
France	5.6540	5.7500
Germany	1.6645	1.6941
Italy	1226.00	1249.00
Japan	134.50	136.05
Mexico	1710.20	1707.00
Switzerland	1.3665	1.3950
U.K.*	1.7960	1.7610

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (11/20/87) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	–0.2%	–5.5%

terms the trade deficit has finally begun to improve, this development is being masked by the value impact of a falling dollar. Thus, the dollar value of imports in September was still nearly nine percent above year-ago levels. Meanwhile, import prices in the third quarter were 15.5 percent above their corresponding 1986 levels. The recent renewed plunge in the dollar will only further exacerbate this trend, not slow it down.

Today's poor world economic climate represents in part the futility of totally relying upon exchange rate movements to rectify imbalances among the major trading countries. The dollar has moved sharply lower, yet the U.S. trade deficit has widened. It seems, therefore, that one solution to the U.S. trade deficit lies in a recession. At present, U.S. consumption is exceeding production; the U.S. is simply saving too little and spending too much. Domestic demand must be curbed, and the October 19 stock market crash was a clear warning of an impending recession. It could be needlessly steep if the major governments of the industrial world continue to postpone tackling their deep-seated problems. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/18/87	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	223.409	+ 1.878	+21.822
Loans to Depository Ins*	.605	+ .089	− .498
Float	1.572	+ .992	+ .156
Total Reserve Bank Credit	241.614	+ 1.929	+20.954
Treasury Deposits with Federal Reserve Banks	3.836	− .122	+ .140
Currency in Circulation	223.525	+ 1.282	+17.977
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	192.067	+ 3.297	+27.549
	11/18/87		
Member Bank Reserves:			
Total Reserves Held	58.098	− .463	+ 3.842
Excess (Deficiency)	.485	− 1.032	− .431
Net Free Reserves	.258	− .972	− .284
Monetary Aggregates †		**% Change Since 3 Months Ago***	**% Change Since Year Ago**
M1 (11/9/87)	759.1	+ 6.9‡	+ 8.1‡
M2 (October '87)	2,890.2	+ 6.0	+ 4.7
M3 (October '87)	3,645.2	+ 6.8	+ 5.9
Domestic Nonfinancial Debt (2nd Q'87)	7,954.0	+ 8.4	+ 11.0

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 11/20/87	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.70%	6.15%	6.43%
* Federal Agencies	6.72	6.85	7.00
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.58	8.18	8.48
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.20	7.35	7.70

‡Finance Company Paper—Prime

5- 14 days	6.50%
15- 29 days	6.65
30- 59 days	6.67
60- 89 days	6.67
90-179 days	6.67
180-239 days	6.50
240-270 days	6.50

‡* Bankers' Acceptances

Dec.	6.82%
Jan.	7.17
Feb.	7.17
Mar.	7.17
Apr.	7.17
May	7.17

‡Industrial Paper—Prime

30- 89 days	6.85%
90-120 days	7.10

†Federal Funds Effective Rate 6.75%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'87	$ 4,512	$ 4,445	$ 4,266
Gross National Product (1982 Dollars)*	3rd Q'87	$ 3,831	$ 3,795	$ 3,718
Percent Change, Annual Rate	3rd Q'87	3.8	2.5	1.4
Change in Consumer Prices*	Oct '87n	4.8% (1)	2.4% (1)	2.4%
Change in Producer Prices*	Oct '87n	− 2.4%	3.6%	3.6%
Civilian Employment (Thousands of Persons) †	Oct '87	113,187	112,772	110,192
Unemployment as % of Civilian Labor Force†	Oct '87	6.0%	5.9%	6.9%
Personal Income*	Sep '87	$ 3,784	$ 3,758	$ 3,568
Leading Indicators Composite Index (1967=100)†	Sep '87	192.5	192.6	179.9
Industrial Production Index (1977=100) †	Oct '87n	131.7	130.9r	125.3
Net Change in Consumer Installment Credit †	Sep '87	$ 6.06	$ 5.01	$ 7.61
U.S. Merchandise Trade Balance	Sep '87n	−$ 14.08	−$ 15.68	−$ 12.56
Plant and Equipment Expenditures*	4th Q'87	$406.37(a)	$398.04(a)	$388.69
Private Housing Starts (Thousands of Units)*	Oct '87n	1,513	1,648r	1,657
New Construction Expenditures*	Sep '87	$ 406.3	$ 400.1	$ 400.1
Total Business Inventories †	Sep '87n	$ 682.4	$ 678.4r	$ 653.7r
Total Business Sales †	Sep '87n	$ 462.1	$ 457.7r	$ 437.2r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.
(1) Indicates new series.

MANUFACTURERS HANOVER

Financial Engineering

Investment Banking Performance

CalFed Inc.

MBank
Momentum Banks
GRIDs™
Group Insured Deposits
Due from 1988 to 1992 at fixed and variable rates.

Republic National Bank of New York
Hong Kong Branch

HK$100,000,000
Three Year Fixed Rate Certificate of Deposit

The Bank of New England

DM50,000,000
Five Year Cross Currency Swap

Reliance Premium Credit Corporation

$160,000,000
Note Issuance Facility

Cananwill, Inc.

Reliance Group Holdings, Inc.

Fireman's Fund Mortgage Corporation

$450,000,000
Multi-Option Facility

The Investment Banking Group

MANUFACTURERS HANOVER

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

First Class Mail
U.S. Postage
PAID
New York, N.Y.
Permit No. 585

Congressional Info. Service
ATT: SRI
4520 E-W Highway
Bethesda, MD 120814

Financial Digest